

No. 2815

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

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THE AMERICAN BANK OF ALASKA,

Plaintiff in Error,

VS.

G. JOHNSON, as trustee in bankruptcy in the
matter of T. Mitchell & Co., a mining co-
partnership consisting of Thomas Mitchell,
Jas. J. Fallon and Herman Fawcett,
bankrupts,

Defendant in Error.

REPLY BRIEF FOR PLAINTIFF IN ERROR.

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F. D. Monckton,
Clerk.

FRANK D. MONCKTON, Clerk.

By.....Deputy Clerk.

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REPLY BRIEF FOR PLAINTIFF IN ERROR.

The brief filed on behalf of the defendant in error, as we view it, practically concedes the case to the bank and substantially the right of the bank to *set off*, as it did, the deposit credit of the value of the gold dust sold to the bank and credited to T. Mitchell & Co. in their general deposit account, and the charging of the overdraft and past due notes against this credit.

The learned counsel open their argument in their reply brief with the statement: "THERE IS NO

DISPUTE ABOUT THE FACTS" (Brief of Defendant in Error, p. 51); with this statement *we agree*; that is the premise of our opening brief.

Their amended complaint (Par. VII, pp. 6-7) expressly alleges the existence with the bank of the general deposit account of T. Mitchell & Co. and *intention* of depositing the proceeds to their deposit account in the bank. Their brief concedes the actual crediting of the deposit to that account and the then charging of the overdraft and past due notes to their account, both in bank book of T. Mitchell & Co. and in the records and books of the bank; all in the usual course of business of the bank and according to the usual course of the previous dealings between T. Mitchell & Co. and the bank (Brief of Defendant in Error, p. 8).

1. That the partnership of "T. Mitchell & Co." had a *general bank deposit and credit account* with the American Bank of Alaska is expressly stated in the amended complaint (Par. VII, p. 6), is expressly alleged in the bank's answer (Par. II, p. 12) and the bank's separate answer and affirmative defense (Par. III, p. 13), admitted by all witnesses and counsel, and proved by the deposit book (Tr. p. 77), and the account itself (Tr. pp. 166a-166b).

2. This account on the evidence of plaintiff's witness *Fallon*, managing partner, was *opened* June 11, 1913, with a deposit of \$200; was *credited* with the *first* cleanup of \$1904 July 3, 1913 (Tr. p. 54); credited with *second* cleanup July 16, 1913

(Tr. p. 56); was credited with the *third* cleanup of \$3750.14 value of gold dust sold to and left with the bank between 5 and 6 o'clock, July 31, 1913 (Tr. p. 59), and "left it to be blown and *credited the same as before* (Tr. p. 63), "with the *intention* of selling the same to the bank and *depositing* the proceeds of such sale in their general deposit account in the bank, having the same *credited* to their deposit account for the purpose of checking against the same" (Amended Complaint, Par. VIII, p. 6).

3. The account on the bank's books in the regular course of its business was charged with *each check as paid* by the bank, with the daily balance or overdraft as it resulted, and on each deposit of the first and second cleanup the bank *credited* the deposit to T. Mitchell & Co. on the books of the bank to the account of T. Mitchell & Co. which account daily showed charged against T. Mitchell & Co. the *checks paid* for T. Mitchell & Co. and balanced their deposit book and returned them their canceled and paid checks (Tr. p. 77, and Tr. pp. 166a and 166b). That was the regular course of business of the bank and was followed in their case always with their acquiescence. *Fallon* testified:

"Q. They didn't treat this *third* cleanup any *different* from what they treated any other deposit in the way it was entered up?

A. *No*. They put it in *just the same as the others*, but instead of acknowledging that they could check against it—to be checked against, I couldn't issue any checks against it,

because it was all taken up on the overdrafts, and the checks that had been issued *during* the cleanup *between the time* of the cleanup" (Tr. p. 74).

Fallon had already testified that the bank, between the time of *this* cleanup, July 16 to July 31, had paid \$3071 for *labor checks* (Tr. p. 67).

The learned counsel in their brief make no attempt to point the Court to any evidence in the record showing:

First. That T. Mitchell & Co. were insolvent as insolvency is defined in section 1, of the Bankruptcy Act of 1898, thus:

"A person shall be deemed insolvent within the provisions of this Act whenever *the aggregate* of his property, exclusive of any property which he may have conveyed, *transferred*, concealed, or removed, or permitted to be concealed or removed, with intent to defraud, hinder or delay his creditors, shall not, at a *fair* valuation, be sufficient in amount to pay his debts";

and this change in the Act of 1898,

"greatly increased the burden on the trustee in cases of this character";

and this means on July 31, 1913, *not* August 23, 1913, when the petition was filed.

Morton, District Judge, in *Clifford v. Morrill*, 230 Fed. 190, decision quoted pp. 85 and 86, of our opening brief.

There is not any evidence showing *what* property T. Mitchell & Co. owned on July 31, 1913, when the

deposit was made with the bank, or what was its *fair* value; and yet the record does show that they then had their valuable lease on a mining claim growing richer with each cleanup; the first was \$1904, the second \$2213.14, and the third, here involved, \$3750.27; although there was no evidence to show what the fair or any value of this lease was; Mr. Bruning testified that they spent \$10,000 about opening up their mining ground, and that was generally considered an asset (Tr. p. 122); and their schedules, filed September 26, 1913, showed they then had other real estate and personal property valued at \$3286 (Tr. p. 38), nothing appearing about their mining lease.

Second. The learned counsel make no attempt whatever to show that on July 31, 1913, or any time previous to the filing of their petition on August 23, 1913, that the bank or Mr. Bruning, its cashier, knew or even had any cause to believe that T. Mitchell & Co. were insolvent. Mr. Fallon testified that the bank *paid* \$3071 of their *labor* checks and \$1800 between July 16 and July 31, 1913 (Tr. pp. 67, 69 and 60); and it is not very likely the bank would have done that if the bank had any suspicion even, let alone reasonable cause to believe, they were insolvent. Mr. Bruning testified he had no knowledge or information of any nature or description or any reason to believe they were insolvent, and that he would not have permitted their overdraft if he had (Tr. pp. 117-122). There is not a syllable of evidence in the record

that the bank or Mr. Bruning knew on July 31, 1913, what property T. Mitchell & Co. owned, or what they owed or what creditors they had or what debts they owed or that they were indebted to anyone in any amount whatever. Mr. Fallon testified in answer to plaintiff's counsel, that there was no intimation on his part to Mr. Bruning as to the amount of checks outstanding for labor (Tr. pp. 83-84), and the same on cross-examination by the bank's counsel (Tr. p. 80), and that their ground was looking better all the time and that they had no intention of quitting work, that the ground was blocked out, everything was in working shape, men were at work and were continuing work, and that he told Mr. Bruning on August 1st that the ground was looking very good and they were going ahead (Tr. pp. 78-79). The garnishment was served on the bank between 8 and 9 o'clock that night, July 31st. Mr. Bruning so testifies (Tr. p. 153), and it was *only after* the garnishment was served that he decided not to allow any more *overdrafts* (Tr. p. 153); Mr. Pratt, testifying for plaintiff corroborates Mr. Bruning that the garnishment was served about 8:30 or 9 o'clock, and also that after that he called Bruning up to know what the garnishment caught, and Bruning told him that the bank had credited the cleanup, and they still owed the bank (Tr. pp. 103-104); and the learned counsel in their brief state that the garnishment was served between 8 and 9 o'clock for \$410.80 (Brief of Defendant in Error, pp. 3, 4).

Third. The learned counsel make no attempt to point out to the Court anything in the record showing that the bank or Mr. Bruning acting for it on July 31, 1913, or at any time, knew or believed or had reasonable cause to believe that in receiving said deposit or in offsetting the overdraft and notes, they were receiving or effecting a preference or receiving a larger percentage of its indebtedness than any other creditor of the same class or any class.

In truth, and we are justified in saying that the learned counsel concede by failing to assert in their brief or make any attempt to point out to the Court any evidence to the contrary in the record, that the bank did not nor did Mr. Bruning, acting on July 31, 1913, for the bank, know or have any reason to believe that T. Mitchell & Co. were insolvent, or that the bank intended to effect a preference of itself, or believed or had any reason to believe that it was effecting a preference whereby it would receive a greater percentage of its indebtedness than any other creditor of the same class.

The learned counsel for defendant in error in their brief place their whole case upon the authority of the decision of the Supreme Court in *Mechanics & Metals Nat. Bk. of N. Y. v. Ernst*, 231 U. S. 60, 66, 58 L. Ed. 121, 124, where a deposit of \$54,048.08 had been made after knowledge of insolvency, but the learned counsel *inadvertently state* in their brief, page 9, that,

“* * * immediately before or immediately AFTER the money reached the bank, the cashier ordered that no more checks of that firm *be honored*, and thereupon appropriated the said sum of money *in part payment* of an indebtedness due it from the bankrupt” (Brief of Defendant in Error, p. 9),

the fact being that the deposit was made *after* such order of the cashier.

Therefore we quote *that* case of *Ernst* and its companion case of *Hotchkiss* (231 U. S. 50, 56, 58 L. Ed. 115, 119).

In the Ernst case the Court said:

“This is an appeal from a decree of the Circuit Court of Appeals, reached upon the same opinion that disposed of *National City Bank v. Hotchkiss*, just decided (231 U. S. 50, ante, 115, 34 Sup. Ct. Rep. 20).

“(The judgment of the District Court will be found in 200 Fed. 295.) *This case* arose at the *same* time and *differs but little* from that in its facts, as to which, as in the other case, the master, the District Court, and the Circuit Court of Appeals all agree.

“The advance in this case was made at about 10 on the following note, to the firm signing it, ‘Please loan us today \$400,000. Crediting this amount to our account, and oblige. J. M. Fiske & Company.’ This sum was credited on the firm’s deposit account, on which there was already \$36,239.47. Before noon the bank certified and afterwards paid checks for \$276,-679.67. Between 11 and 12 the *cashier, hearing that there was trouble* in the stock market and *with J. M. Fiske & Company, ordered that no more checks should be paid or certified. He then went* to the brokers’ office, saw Mr. Sherwood, a member of the firm, at about 12, and

after getting an *evasive answer* to an inquiry *as to the rumor*, said that the firm had made no deposits on that day, and was told that one was on its way. (*\$54,048.08 were in fact paid in after the cashier's order to stop payment.*) He then told Mr. Sherwood that he had better give him some securities, that he ought to give additional securities on the bank's loans, and after consultation Mr. Sherwood did so, and the cashier returned to the bank. We may assume for purposes of decision that the securities, with a small exception, were obtained by the use of the clearance loan.

"At 40 minutes after 12 the brokers gave notice to the stock exchange that they were unable to meet their obligations, and an involuntary petition in bankruptcy was filed against them at 25 minutes past 3. This suit is for the proceeds of the securities (which were sold by the bank), *and for the sum deposited as we have stated.* In view of our decisions in the other case, only one or two matters need mention. It is somewhat more pressed that the bank had not reasonable ground to believe that the brokers' property at a fair valuation would be insufficient to pay their debts, and therefore had not ground to believe that the brokers were insolvent within the meaning of the bankruptcy act, Sec. 1 (15). We think it too plain to need argument that the findings below that the firm was insolvent, knew that it was insolvent, and intended a preference, were correct. These brokers were ruined by the collapse of the pool mentioned in the other case, and apart from any knowledge that the bank may have had as to their interest in the stock concerned, the entirely unusual course of the cashier in leaving his bank to get additional security (not merely proceeds of the clearance loan upon a claim of lien) and the circumstances are sufficient

to prevent our going behind the finding below. Really no other conclusion could have been reached."

In the Hotchkiss case, 229 U. S. 50, *companion* to the Ernst case, similar *preferences* were received in the way of securities, *after* similar knowledge with the bank officers, and while the trustee claimed the deposits and securities made and given by the bank *after* such knowledge were preferences and the Courts all so hold, and *no one*, either trustee, creditor or Court, questioned the deposits made on the *same day*, some few hours *before* the bank obtained that knowledge; and the Supreme Court, relating to such deposits made *before*, said (Tr. pp. 55-56):

"During the day the firm made *deposits* which are *not* in question, but there remained due upon the loan \$166,166.69. Officers of the bank, noticing the drop in the stock, went to the firm, *demanding payment* or securities to make good the obligations to the bank, *and were told of the suspension* and that a petition *in bankruptcy* would be filed. After two hours' discussion the *securities* in question were delivered between 2 and 3 p. m., but the officers were *told* that the delivery was *a preference*";

and the petition in bankruptcy was filed about 4 p. m. of the same day (Tr. p. 55).

In the case before your honors, this deposit and credit to the general deposit account of T. Mitchell & Co. and the offset had been made *before* 6 p. m. (Tr. p. 153); the garnishment for \$410 was not levied until between 8:30 and 9 p. m. (Tr. pp.

103-104); the petition in bankruptcy was *not* filed until August 23, 1913 (Tr. p. 25); and there is not a particle of evidence that the bank or Mr. Bruning knew anything at all about the financial condition of T. Mitchell & Co. except with the bank, or that they were insolvent or that this deposit would effect a preference or a greater percentage of their indebtedness than any other creditor of the same or any class, or that the bank intended a preference, or that there was any suspicion of fraud or collusion.

In *Studley v. Boylston National Bank*, 229 U. S. 523, 57 L. ed. 1313, referring to *New York County Nat. Bank v. Massey*, 192 U. S. 138, 48 L. Ed. 380, the Supreme Court, by Justice Lamar, said:

“An effort is made to distinguish that case from this, by calling attention to the fact that here, by checks drawn on the account or notes charged to the account, the parties themselves voluntarily made the setoff before the petition was filed; while in the *Massey* case the trustee, under the supervision of the referee, stated an account and allowed the setoff as permitted by 68a, which provides ‘that in all cases of mutual debt, or mutual credits between the estate of a bankrupt and a creditor, the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid’.

“That section did not create the right of setoff, but recognized its existence, and provided a method by which it could be enforced even after bankruptcy. What the old books called a right of stoppage—what business men call setoff—is a right given or recognized by the commercial law of each of the states, and

is protected by the bankruptcy act if the petition is filed before the parties have themselves given checks, charged notes, made book entries, or stated an account whereby the smaller obligation is applied on the larger.

“The banker’s lien on deposits, the right of retention and setoff of mutual debts, are frequently spoken of as though they were synonymous, while in strictness, a setoff is a counterclaim which the defendant may interpose by way of cross-action against the plaintiff. But, broadly speaking, it represents the right which one party has against another to use his claim in full or partial satisfaction of what he owes to the other. That right is constantly exercised by business men in making book entries whereby one mutual debt is applied against another. If the parties have not voluntarily made the entries, and suit is brought by one against the other, the defendant, to avoid a circuitry of action, may interpose his mutual claim by way of defense, and if it exceeds that of the plaintiff, may recover for the difference. Such counterclaim can be asserted as a defense or by the voluntary act of the parties, because it is grounded on the absurdity of making A pay B when B owes A. If this setoff of mutual debts has been lawfully made by the parties before the petition is filed, there is no necessity of the trustee doing so. If it has not been done by the parties, then, under command of the statute, it must be done by the trustee. But there is nothing in 68a which prevents the parties from voluntarily doing, before the petition is filed, what the law itself requires to be done after proceedings in bankruptcy are instituted.

“The bank was indebted to the Collver Company as a depositor some \$54,000 for money deposited in good faith in the usual course of business, and with no purpose of enabling

the bank to secure the right of setoff. The Collver Company, on the other hand, was indebted to the bank \$25,000 on notes maturing at various dates. These were mutual debts, and if, on the date the first note became due, the Collver Company had failed to pay it, the bank could have enforced its banker's lien or its right of setoff, by applying \$5000 of the deposits in payment of the note which matured that day, and so on as each of the other notes became due. It cannot have been illegal for the parties on September 12, 20, 30, October 3 and 14, to do what the law would have required the trustee to do in stating the account after the petition was filed on December 16, 1910. No money passed in either instance; for, whether the checks for \$5000 were paid or notes for \$5000 was charged was, in either event, a book entry equivalent to the voluntary exercise by the parties of the right of setoff.

The bankruptcy act recognizes this right, and it cannot be taken away by construction because of the possibility that it may be abused. The remedy against that evil is found in the fact that the trustee is authorized to sue and recover *if it is shown that after insolvency the money was deposited for the purpose of enabling a bank or other creditor to secure a preference.* But to deny the right of setoff in cases like this, would in many cases make banks hesitate to honor checks given to third persons, would precipitate bankruptcy, and so interfere with the course of business as to produce evils of serious and far-reaching consequence."

In *Lowell v. International Trust Co.*, 158 Fed. 781, 783, 784, the Circuit Court of Appeals for the First Circuit, where a voidable preference by payment, was asserted, the Court held:

“The plaintiff also urges on us that in *New York Bank v. Massey*, the bank took no action formally or otherwise, but merely left it to the law to offset the deposit made by the bankrupt against his indebtedness, while in the case at bar we must accept the statement that the defendant charged up its demand loans against the deposit, or in other words, went through the formalities of certain alleged journal entries. This, however, was ineffectual either way, whether to benefit or prejudice the International Trust Company. It only gave expression to what the law itself would accomplish, that is, it cleaned up the setoff and left it where the law itself would have left it. At law, it takes two parties to accomplish an effectual payment, both a payor and a payee. Sometimes, of course, the law appropriates moneys in payment, or permits the creditor to do it; but that is in consequence of some express or implied understanding between the parties. In such instances an intention on the part of both parties to make payment on some indebtedness underlies what the law accomplishes, and the law is called in only because, while payment is intended, the particular item of indebtedness to which it shall be appropriated is not specifically pointed out. In no sense, however, is a deposit like the deposit here payment, or intended as payment. This is the first condition of the decision in *New York Bank v. Massey* and a vital one; because if a deposit in the usual course of business may be in the nature of a payment, an unlawful preference would necessarily be involved under the circumstances of either *New York Bank v. Massey* or the case at bar, a suggestion of a possibility which the Supreme Court was compelled to negative.

“What the International Trust Company did in the case at bar more than what was done in

New York Bank v. Massey was, as we have said, simply to give form to what the law itself accomplished in substance. Moreover, *if what was done by the International Trust Company* in distinction from what was done by the creditor in New York Bank v. Massey, *accomplished a preference*, and for that reason *was invalid or had been invalidated*, the *condition prior to the charging up the demand loans would have been restored by force of law*, and the deposit would remain with the International Trust Company, *precisely as it did in the case before the Supreme Court*, and also the law would be left to operate in precisely the same manner. All this, therefore, raises *no substantial difference* which we can discover to relieve us from the conclusions of the Supreme Court in the case on which the International Trust Company relies.

“In addition to the above, we refer to the decision of the Circuit Court of Appeals in the Seventh Circuit in *Re George M. Hill Co.*, 130 Fed. 315, 64 C. C. A. 561, 66 L. R. A. 68. This case was decided only a few months after *New York Bank v. Massey*, and at page 318 of 130 Fed., at page 564, of 64 C. C. A. (66 L. R. A. 68), it was rested thereon. In that case it appears, at page 316 of 130 Fed., at page 563 of 64 C. C. A. (66 L. R. A. 68), that two days before the filing of the petition in bankruptcy the creditor bank appropriated the balance of the deposit account precisely as was done in the case before us. No distinction was made by the Circuit Court of Appeals on that account. It is true that the attention of the court does not seem to have been specifically called thereto; but the facts indicate that none of the parties to that litigation perceived any distinction on account thereof.”

It is respectfully submitted the judgment brought to this Court by writ of error should be reversed, with directions to the District Court as requested in the conclusion of our opening brief.

Dated, San Francisco,
February 27, 1917.

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